2025 Global Fixed Income Outlook

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The results of the U.S. presidential election are on many investors' minds heading into 2025. What are the potential implications for global fixed income markets?

BP: Donald Trump's victory, at a high level, will likely mean stronger growth and less regulation—and the U.S. high yield market was very quick to price that scenario in following the election. From a sector standpoint, the effects of Trump's policies on energy will be interesting. While energy rallied following the election, it's unclear whether a so-called "drill baby drill" scenario is necessarily a good outcome for the sector, or whether it will meaningfully increase supply—especially since prices, not regulation, have been the key determinants of energy supply in recent years. And of course, there are demand and geopolitical elements that could impact the picture as well.

RA: From a geopolitical standpoint, there is a perception that risks are waning now that the election is behind us. That may be true to an extent—especially regarding Russia-Ukraine and the Middle East—but I do have nagging concerns that the market may be getting overly optimistic given the vast array of complicating factors surrounding each of these geopolitical crises.

OL: With regard to both EM and European corporates, tariffs are a major source of uncertainty under Trump 2.0 and an issue we're monitoring closely. China is another unknown, particularly for EMs. Under the first Trump administration, we saw a reorientation of trade from China to other parts of the world. Looking ahead, we expect there to be winners and losers across EM in a global tariff war. Commodity exporters and countries with strong domestic economies will likely show some resilience. But the market may be underpricing the extent to which China can and probably will fight back economically.

Despite the uncertain environment, credit spreads continue to tighten. Is there a disconnect between what you're seeing from the top down and bottom up?

BP: High yield spreads are tight relative to history, but there are reasons for this. From a macro perspective, recession and political risks, while still present, appear to be moderating—and credit loves moderation. The high yield market is also as high-quality as it's arguably ever been, with BBs making up just over half of the market.[1] From a fundamental standpoint, high yield issuers are in good financial health overall, despite pockets of weakness in retail and other consumer-oriented sectors. Technical forces in the form of strong demand and low supply are providing further support.

CS: The bottom-up picture is similarly positive for IG credit. Technicals are notably strong, and demand remains robust—particularly from yield-focused insurers that are seeking to match the liabilities coming from surging demand for fixed annuities. Fundamentals are also strong across the U.S. and Europe, with corporate earnings having largely recovered to pre-pandemic levels. That said, leverage continues to creep up, suggesting that the tightness in spreads may not be fully justified by the fundamental picture, particularly given the potential for volatility going forward.

What are your best ideas for fixed income investors in 2025?

OL: EM corporate debt is certainly coming off a challenging several years, but for investors who are allocated to the asset class and questioning whether the returns are justifying the risks, I would point to a few considerations. For one, EM corporate debt's Sharpe Ratio, at 0.8x, is attractive relative to both history and other fixed income asset classes despite all the perceived headline noise.[3] Corporate fundamentals across the asset class are also solid—issuers have maintained manageable debt levels, and default rates remain in line with historical averages. Given the sheer diversity of the EM corporate universe and the low correlation to some other asset classes, it can also serve as an effective diversifier in a broader fixed income allocation.

All of that said, 2025 will likely be a year of uncertainty, which means rigorous, bottom-up credit analysis will be key to uncovering the idiosyncratic stories—the "winners"—that are positioned to benefit. EM businesses with U.S.-based operations, for example, look well-positioned amid what we expect to be near-term exceptionalism. In the likely event of a stronger U.S. dollar, EM exporters that have hard currency revenue streams could benefit. Defensive sectors also look compelling given the prevailing uncertainty.

RA: 2025 also looks compelling for EM sovereign debt. Now that the U.S. Federal Reserve has transitioned from quantitative easing to purely using interest rates, we believe global commercial banks will increase their lending to levels more in line with history. Given the diversification potential and other attractive characteristics underlying EM, we expect direct investment flows into EM to return as well—something we believe the market may be missing. Against this backdrop, high yield sovereign hard currency looks particularly attractive. Spreads in many cases remain significantly wider today than before the pandemic, and we continue to believe the risk-reward profile is particularly compelling in BB sovereigns with strong fundamentals.

BP: Heading into 2025, we see benefits to being long U.S. loans with an overlay of Treasury futures. There is not much excess return in spreads at the moment—rather, we're in a carry environment, and loans offer substantial carry. In the event that we see a step-change in interest rates, particularly if rates decline more than expected, Treasury futures offer some protection. In the context of a short duration and high-quality market, we believe this is a combination that should fare well under different scenarios.

CS: Depending on an investor's needs, there are compelling opportunities across any pocket of the credit markets. For insurance investors, particularly annuity buyers, elevated rates present compelling opportunities along the front end of the curve, whereas the long end of the curve looks more attractive for whole life buyers. For relative return investors, although spreads have compressed, there are interesting opportunities in less followed/less liquid issuers, especially in the financial sector, with aircraft lessors, business development companies, and select BBB insurance companies offering value.

Watch the full webinar here:

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[1]Source: ICE BofA. As of September 30, 2024.
[2]Source: Bloomberg Intelligence. As of September 2024.
[3]Source: J.P. Morgan. As of September 2024.